***SOVEREIGN*: Trinidad and Tobago**

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Summary

The domestic economy in Trinidad and Tobago is slowing evolving with growth expected upward of 2% over the medium term due largely to activities in the petroleum sector. Owing to ongoing fiscal consolidation, further reduction is expected in the deficit and the debt. As a result of continued normalisation of monetary policy in the US and the attendant impact on the sovereign's financial accounts, the Central Bank of Trinidad and Tobago (CBTT) increased the repo rate in June. Further rate hikes are expected in in the future consistent with activities in the domestic economy, particularly the non-petroleum sector, and rate rise in the US.

Improving Growth, a catalyst for debt reduction

The sovereign's economic outlook is positive over the medium-term, particularly in the energy sector. The Government needs to however continue with the raft of fiscal reforms to help streamline the fiscal deficit and reduce the debt to GDP path. Fiscal operations for FY 2017/18 is running ahead of the projected path, and as such the deficit should be lower than programmed. In Late June the Central Bank of Trinidad and Tobago increased the repo rate to help preserve the external account and ease currency pressures.

Real economic growth is likely to hit the 2% mark at the end of the year due mainly to increased output in the Petroleum sector. The medium-term forecast for overall growth is looking positive on account of continued improvements in natural gas production and higher projected future prices. Start-up operations by British Petroleum's Juniper field has contributed to increased production of natural gas which has helped to ease the supply shortages that has negatively affected downstream production in recent years. A number of other operations are slated to come on stream over the forecast horizon, including increased operations by Shell Trinidad & Tobago Limited (SHELL) and BHP Billiton Ltd. (BHP). Assuming these facilities come on stream and prices as envisaged hold, then growth is likely to remain positive in the Petroleum sector over multiple periods.

Unlike the Petroleum sector, the Non-Petroleum sector which accounts for 80% of overall domestic output is likely to continue to experience inertia due to slowing household spending and lower exports to the wider Caribbean. The slow growth in the sector coupled with the scale down of government spending is having a negative effect on the proportion of persons without work. In fact unemployment is on the rise, moving to 5.3% in June 2017, up from 4.4% in June 2016. The Central Statistical Office (CSO) has not published any data subsequently, but the International Monetary Fund (IMF) is estimating that youth unemployment was 12% in 2017 compared to approximately 8% in 2014. We recalibrated our projections for unemployment and as such we are expecting the unemployment rate to stabilize at around 5.6% over the medium-term. This will act as a further drag on the economy and help mitigate the effect of growth in the petroleum sector on the wider economy.

Fiscal Operation

Fiscal operation is improving relative to previous years and such the deficit is expected to trend down to 2% in 2018 from nearly 9% in 2017. The improvement is being driven by better than planned tax collection and reductions in spending on transfers and subsidies, goods and services, and capital investment. The fiscal buffer accumulated over the years through the Heritage Stabilisation Fund (HSF) provides a cushion for the authorities to draw on when needed. Last fiscal year the authorities drew down on the HSF and sold assets to help finance the budget. The said strategy is being employed this fiscal year. This however cannot continue indefinitely as the government has a finite amount of assets and the pool has depleted in recent years. Thus, a more comprehensive solution to address the sovereign revenue needs is required over the medium term. The authority has signalled that it will be employing a medium-term fiscal framework, which fully articulates the spending and expenditure needs of the sovereign over a four year period. This will go a far way to help with fiscal planning and eliminate the guess work surrounding fiscal operations. This is a key guideline for the public and more so businesses.

Although energy prices have increased, revenue from the petroleum sector remains flat because of the fiscal incentives that were given. We are projecting revenue to GDP to grow by 2 percentage points in 2018 to 28.2% which largely reflects tax increases. Looking over the medium-term, revenue is expected to rise at a slower pace as the marginal impact of taxation peters out and the impact of taxation on increased GDP slows because of increased unemployment. Central government debt levels are expected to fall over the forecast horizon, which largely reflects consolidation of fiscal operations and positive real growth.

Figure 1: Selected Macroeconomic Indicators

Indicator Name	2015	2016	2017	2018 (e)	2019 (f)	2020 (f)	2021 (f)
GDP per capita, USD	17,389	15,451	15,727	16,485	15,356	12,504	13,880
Real GDP growth, % y-o-y	-0.6	-5.1	-0.3	2.0	2.5	2.3	1.8
Unemployment, % of labour force, eop	3.5	3.6	5.0	4.2	4.0	4.0	4.0
Inflation, eop	1.5	3.1	1.3	2.0	2.8	5.0	5.0
Budget balance, % of GDP	-1.8	-5.7	-8.7	-2.7	-2.6	-1.9	-1.5
Foreign reserves ex gold, USDbn	9.9	9.5	8.4	7.5	7.8	8.3	8.7
Import cover, months	13.9	12.1	10.4	8.3	8.1	8.3	8.5
Total government debt, % of GDP	52.3	63.8	62.8	62.5	62.8	61.5	59.3
Total revenue, % of GDP	38.1	32.2	26.1	28.2	29.8	29.8	29.1
Current expenditure, % of GDP	34.8	34.7	32.3	29.0	29.5	28.9	28.0
Primary balance % of GDP	0.5	-3.0	-5.6	0.6	0.9	1.9	2.4

Sources: BMI and JMMBIR

Interest rate rise: what the central bank's next move is?

Prior to the rate adjustment, the Trinidad and Tobago Central Bank policy rate (repo) had held steady at 4.75% since Q4:16 despite pressure in the currency market and a decline in reserves. Rates were held stable due to the need to provide an enabling environment for growth in the non-petroleum sector, which has been negatively impacted by subdued domestic household spending and lower real growth in source countries for exports throughout the Caribbean. Notwithstanding the best effort of the CBTT, pressures have been building in the external accounts due in part to the reduction in interest rate differential between the US- and TT-dollar denominated assets. The differential went into negative territory on the short tenured instruments. Despite the sovereign generating a current account surplus, there was net outflows in the financial accounts and a reduction in reserves.

As we have noted in previous publications, the issue was never around whether repo rates would increase but a matter of when. Given the posture of the Federal Reserve (Fed) and strong growth and job market outlook in the US economy, normalisation of monetary policy was expected to continue apace with further rate hikes in 2018 through to 2019. The CBTT therefore is compelled to increase interest rates to maintain the spread differential and relative attractiveness of TT assets. Making small or moderate adjustments to rates is always a better option that waiting to make large one-off adjustments which could be disruptive to the economy.

Opinion

Trinidad and Tobago has exited recession and the economy is on a forward growth path that is heavily reliant on activities in the petroleum sector. Fiscal consolidation and subdued activities in the non-petroleum sector will limit upside growth over multiple periods. Despite the growth outlook, unemployment is likely to rise as the government scales back on 'social work programmes.' It will take some time before the rise in repo rates affect domestic interest rates as the monetary transmission mechanism is relatively weak and there is excess TT-dollar liquidity in the banking system. We are expecting the CBTT to enter a cycle of rate increase which is correlated with the evolution of rate hikes in the US, but with a lag of approximately 2 quarters. While the CBTT remains steadfast in preserving the repo rate in order to facilitate improved economic activities in the non-petroleum sector, it will have to carefully gauge this against the risk of outflows of funds from portfolios in search of higher returns.

The TT-dollar has held its own against the US-dollar despite excess demand in the currency market. The central bank continues to dictate conditions in the market and to prioritise flows to the productive sector. Notwithstanding, suppliers have to be queuing for currency and it is having a negative impact on their businesses as they are finding it increasingly difficult to meet their obligations. External credit is quickly drying up because of this situation which is not expected to ease in the near term despite increased petrocurrency flows as outflows via the financial accounts are growing at a faster pace.

Source: Central Bank of Trinidad and Tobago, IMF

APPENDIX

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